



OFFICE OF FINANCIAL MANAGEMENT

A DESCRIPTION OF **WASHINGTON STATE'S BUDGET PROCESS**



BUDGET DIVISION

August 2002

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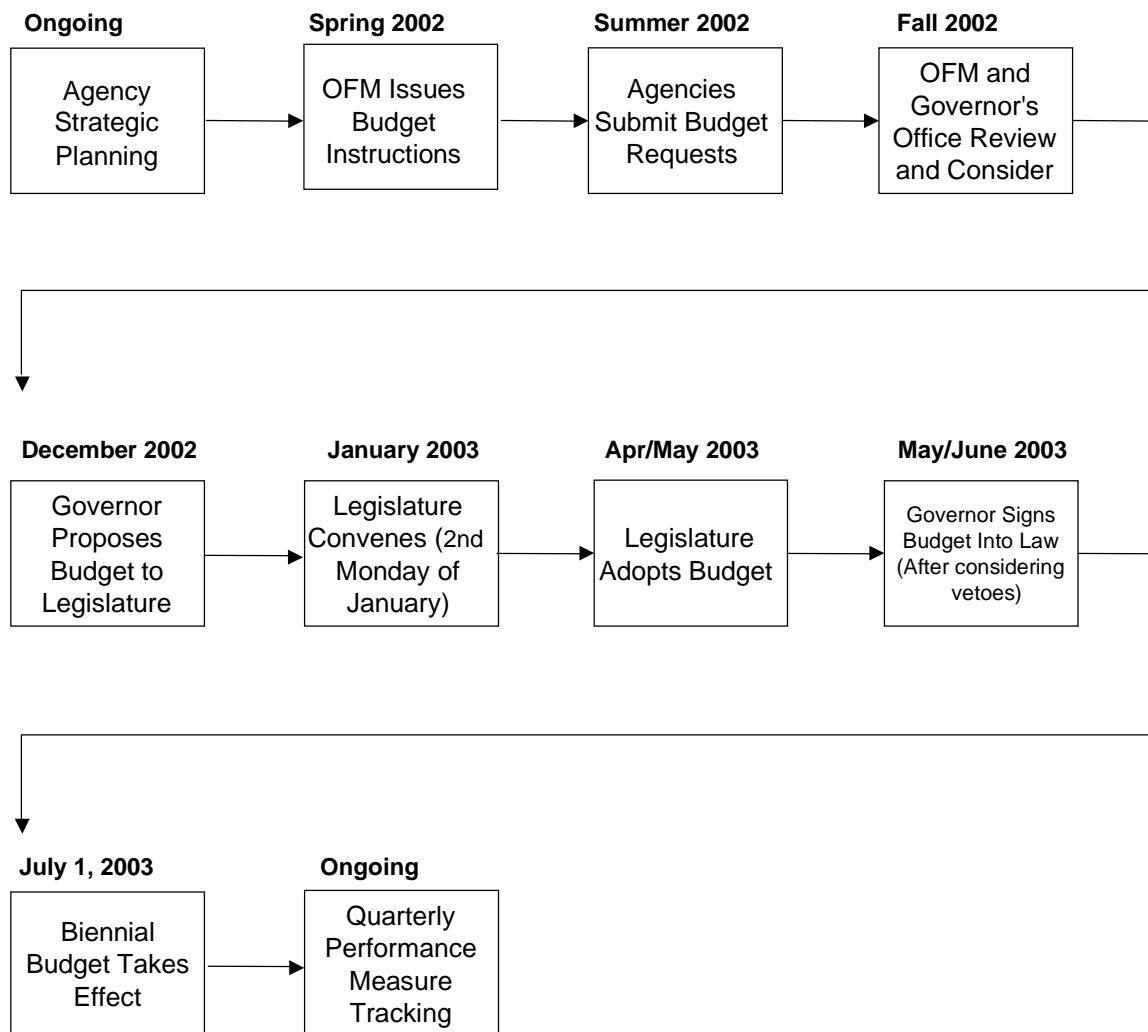
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WASHINGTON STATE 2003-05 BUDGET

Biennial Budget Process





A DESCRIPTION OF

Washington State's Budget Process

The Biennial Budget Cycle

Like 21 other states, Washington enacts budgets for a two-year cycle, beginning on July 1 of each odd-numbered year. The budget approved for the 2001-03 Biennium remains in effect from July 1, 2001 through June 30, 2003. By law, the Governor must propose a biennial budget in December, the month before the Legislature convenes in regular session. The biennial budget enacted by the Legislature can be modified in any legislative session through changes to the original appropriations. Since the inception of annual legislative sessions in 1979, it has become common for the Legislature to enact annual revisions to the state's biennial budget. These revisions are referred to as supplemental budgets.

Roles and Responsibilities in the Budget Process

State agencies are responsible for developing budget estimates and submitting budget proposals to the Governor. Once the budget is enacted by the Legislature, agencies implement approved policies and programs within the budgetary limits imposed by legislation. Under Washington's budget and accounting statutes, individual agency directors are accountable for carrying out the legal intent of appropriations.

The **Governor** recommends a budget to the Legislature consistent with executive policy priorities. Appropriation bills, like other legislation, are subject to gubernatorial veto authority and may be rejected in part or in their entirety within a defined number of days after legislative passage. After a budget is enacted, the Governor's general administrative duties include monitoring agency expenditures and helping to achieve legislative policy directives.

The **Office of Financial Management (OFM)** coordinates the submittal of agency budget requests and prepares the Governor's budget recommendation to the Legislature. Budget staff from OFM work closely with state agencies to explain and justify planned expenditures. Analysts evaluate all budget requests for consistency with executive policy priorities and to ensure that proposed expenditures match fiscal constraints. OFM is also responsible for maintaining the state's central accounting system and developing certain population and demographic forecasts.

Through appropriations bills, the **Washington State Legislature** mandates the amount of money each state agency can spend and, in varying degrees of detail, directs agencies where and how to spend it. Washington's bicameral legislature consists of 49 senators in the Senate and 98 representatives in the House. Specific fiscal committees have primary responsibility for preparation of the legislative budget. These include the Appropriations, Capital, Finance, and

Transportation committees in the House; the Ways and Means, and Transportation committees in the Senate; and the Joint Legislative Transportation Committee.

The House and Senate employ staff analysts to help review and evaluate the state budget, and to prepare appropriation bills. As with other legislation, if the two houses cannot agree on a budget or revenue proposal to implement the budget, a conference committee of legislative representatives may be convened to reconcile the differences.

The **Economic and Revenue Forecast Council** is composed of representatives from both the legislative and executive branches. Each fiscal quarter, the Council adopts an official forecast of General Fund-State (GF-S) revenues for the current and (at some point) the ensuing biennium. These forecasts, together with any reserves left over from previous biennia, determine the financial resources available to support estimated expenditures.

The **Caseload Forecast Council** was created by the 1997 Legislature and began operations in the 1997-99 Biennium. The Council consists of two members appointed by the Governor and four appointed by the legislative political caucuses. The Council prepares official caseload forecasts for state entitlement programs, including public schools, long-term care, medical assistance, foster care, adoption support, adult and juvenile offender institutions, and others.

The **State Expenditure Limit Committee**, consisting of legislators and representatives of the Governor and Attorney General, was established in 2000 to determine the state General Fund expenditure limit created by Initiative 601.

Budget Development Approach

Washington State's budget process cannot be characterized by any single budget decision model. Elements of program, target, and performance budgeting along with the traditional line item budgeting associated with objects of expenditure (e.g. salaries, equipment) are all used in budget decision-making. In general, Washington focuses on the expected changes in services and performance that can be achieved through revisions to the current expenditure base.

Like many other states, Washington is attempting to improve its budget process by incorporating more performance-based measurements of success to help clarify the relationship between resources and outcomes.

Budget and Accounting Structure

State government is organized into 117 agencies, boards, and commissions representing a wide range of services. While many state agencies report directly to the Governor, others are managed by statewide elected officials, or independent boards appointed by the Governor. Most agencies receive their expenditure authority from legislative appropriations that impose a legal limit on operating and capital expenditures. Appropriations are authorized for a single fund, although individual agencies frequently receive appropriations from more than one fund.

A few agencies are "nonappropriated," meaning that they operate from a fund that is legally exempt from appropriation. Expenditures by these agencies are usually monitored through a biennial allotment plan. There is no dollar limit as long as expenditures remain within available revenues and are consistent with the statutory purpose of the agency.

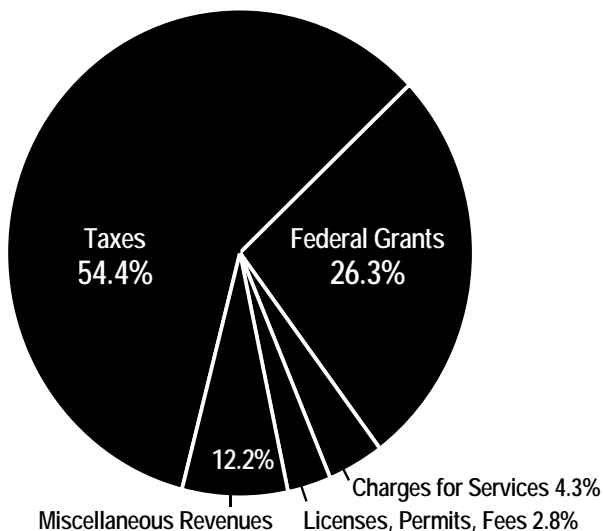
The state's budget and accounting system includes more than 400 discrete funds, which operate much like individual bank accounts with specific sources of revenue. The largest single account is the state General Fund. State collections of retail sales, business, property, and other taxes are deposited into this account. Expenditures from the state General Fund can be made for any authorized state activity subject to legislative appropriation limits.

Other funds are less flexible. Certain revenues (for example, the motor vehicle fuel tax or hunting license fees) are deposited into accounts that can only be spent for the purpose established in state law. In budget terms, these are referred to as "dedicated accounts."

Sources of State Revenues

Washington receives most of its revenue from taxes, licenses, permits and fees, and federal grants. Each individual revenue source is designated by law for deposit into specific accounts used to support state operating or capital expenditures.

**Sources of State Revenues 4 All Governmental Funds
Fiscal Year 2001 (Annual Amount)**



| Category | Dollars in Millions |
|-------------------------|---------------------|
| Taxes | \$ 11,908 |
| Federal Grants | 5,757 |
| Charges for Services | 952 |
| Licenses, Permits, Fees | 614 |
| Miscellaneous Revenues | 2,656 |
| TOTAL | \$ 21,887 |

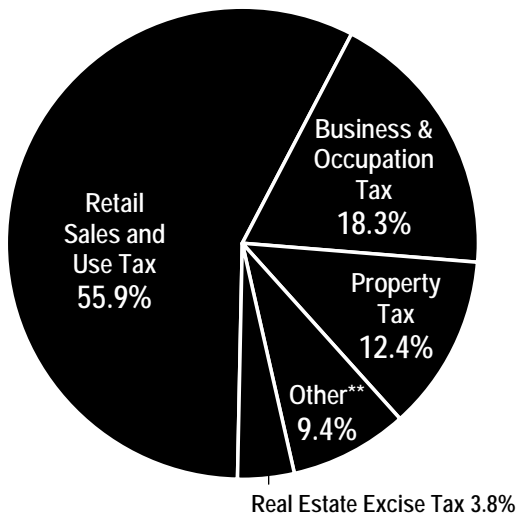
*SOURCE: 2001 State of Washington
Comprehensive Annual Financial Report (OFM).*

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The chart below displays the major revenue sources for General Fund-State expenditures in the current biennium. The Department of Revenue collects most of these revenues.

Sources of General Fund-State Revenues 2001-03 Biennium Estimate*



| Category | Dollars in Millions |
|---------------------------|---------------------|
| Retail Sales and Use Tax | \$ 11,825 |
| Business & Occupation Tax | 3,869 |
| Property Tax | 2,614 |
| Other** | 2,037 |
| Real Estate Excise Tax | 795 |
| TOTAL | \$ 21,140 |

* Source: June 2002 - Revenue Forecast Council - GF-S Cash Basis.

** "Other" includes revenue from real estate excise taxes, liquor sales, tobacco taxes, lottery proceeds, and insurance premiums.

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Size and Distribution of the State Budget

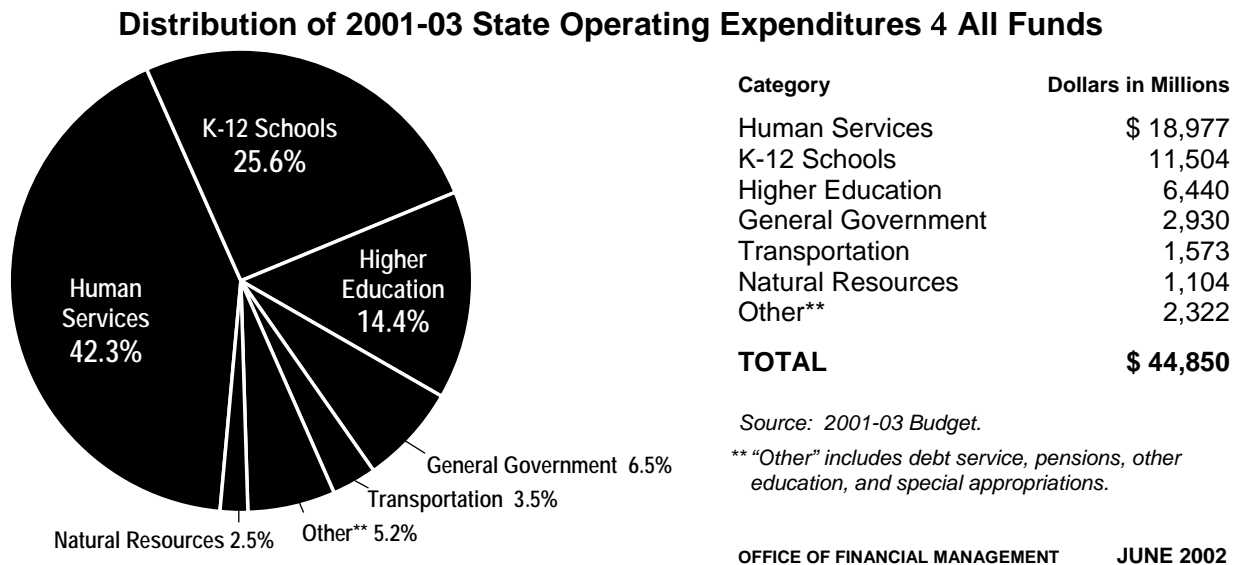
The state's current operating budget for the 2001-03 Biennium (from all fund sources) is \$44.9 billion. A separate capital budget finances major building, renovation, and land acquisition projects. The 2001-03 (non-transportation) capital budget for new projects is \$2.6 billion. An additional \$1.5 billion is available in reappropriated funds to allow the completion of capital construction projects authorized in previous biennia. Roads, bridges, and other transportation capital projects are budgeted at \$2.8 billion. (Total Operating/Capital Budget = \$51.8 billion).

Operating expenditures are supported by general state tax revenues, federal funds, dedicated tax and fee revenues, and other miscellaneous sources such as earned interest and lottery receipts. The capital budget is primarily funded through general obligation bonds (\$966 million in 2001-03), and cash revenues from dedicated accounts. The debt service on non-transportation general obligation bonds is paid by General Fund-State resources in the operating budget.

State operating expenditures can be grouped into seven broad categories of services:

- # **Human Services**, such as mental health and other institutions, public assistance, health care, and correctional facilities.
- # **Public Schools**, which represents state support for Kindergarten4Grade 12 (K-12) education.
- # **Higher Education** in public universities, community colleges and technical schools.
- # **Natural Resources** expenditures for environmental protection and recreation.
- # **Transportation**, which includes highway maintenance, state ferry operations, and the State Patrol.
- # **General Government**, including the administrative, judicial and legislative agencies.
- # **Other** (miscellaneous) expenses, such as the payment of debt service and pension contributions.

The following chart shows the distribution of expenditures from all funds for the 2001-03 Biennium.

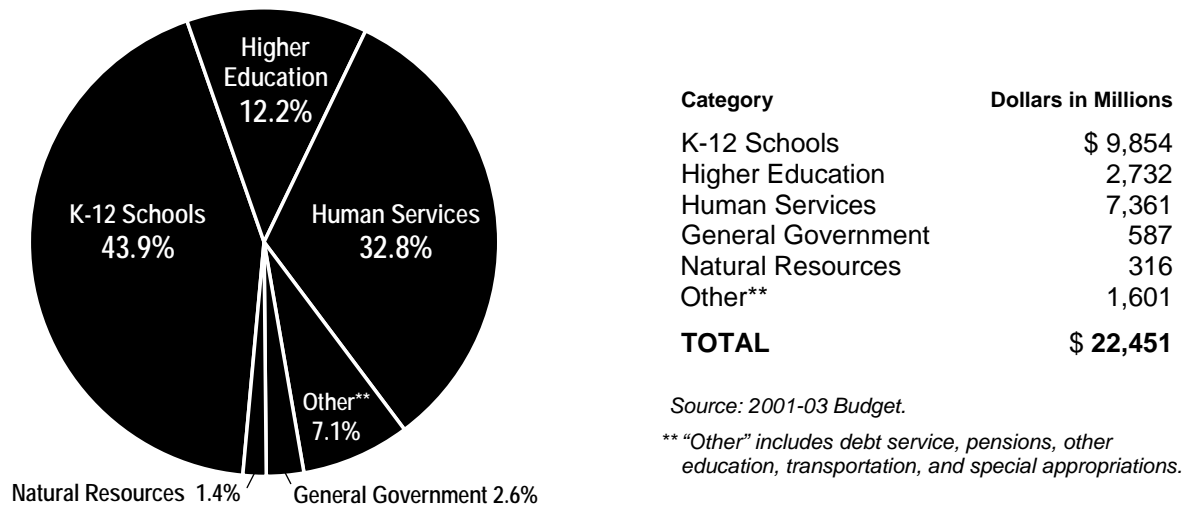


The General Fund-State Operating Budget

Approximately \$22.5 billion 4 about half 4 of the state operating budget for 2001-03 is supported by General Fund-State (GF-S) tax revenues and reserves. Because the Governor and Legislature have the greatest discretion over how these state revenues are spent, programs supported by GF-S receive substantial attention during budget deliberations.

The following chart shows the distribution of estimated General Fund-State expenditures for the 2001-03 operating budget. About 56 percent of the state General Fund is spent on education, which includes the state share of funding for public schools (K-12), four-year colleges and universities, and two-year community and technical colleges.

Distribution of 2001-03 State Operating Expenditures 4 State General Fund



GF-S Expenditure Trends 1983-85 to 2001-03

| Biennium | Dollars in Millions | Change in Millions |
|----------|---------------------|--------------------|
| 1983-85 | \$7,957.6 | \$1,417.1 |
| 1985-87 | 9,181.3 | 1,223.7 |
| 1987-89 | 10,403.8 | 1,222.5 |
| 1989-91 | 12,844.2 | 2,440.4 |
| 1991-93 | 14,982.6 | 2,138.4 |
| 1993-95 | 16,315.1 | 1,152.5 |
| 1995-97 | 17,731.0 | 1,595.9 |
| 1997-99 | 19,158.0 | 1,427.0 |
| 1999-01 | 21,046.4 | 1,888.2 |
| 2001-03* | 22,451.2 | 1,405.0 |

*2001-03 Biennium figures are based on appropriations as of June 2002. Previous biennia represent actual expenditures. Dollars have not been adjusted for inflation.

State Staffing Levels

The current state budget assumes approximately 101,200 FTEs on an annual basis, with the largest number of people employed in transportation, higher education institutions, correctional facilities, and state social service and health agencies. For budget purposes, the number of state employees is measured in Full Time Equivalent (FTE) staff years: i.e. one person working 40

hours a week for a full year is counted as one FTE staff year. Two people working half time also count as one FTE. Although the state provides funding for compensation for local school teachers, this support is in the form of grants. Therefore, K-12 teachers are not considered state employees in statewide FTE statistics.

Budget Drivers

In addition to new policies adopted by the Governor, Legislature, or federal government, the state budget can also be significantly influenced by demographic and economic factors. Differences in these "budget drivers" affect the cost of services, or the number of persons that require services. An example of the demographic connection appears in K-12 education, where expenditures for the state's constitutionally mandated responsibilities for basic education are closely tied to the number of school-age children in the state. Based on a demographic analysis, the state is planning future budgets on the assumption that population pressures will be strong through the remainder of the decade in the areas of higher education, juvenile rehabilitation, and nursing homes.

Spending Limits in the State Budget

Major Provisions of Initiative 601 (initially enacted in 1993, modified in 2000):

Fiscal Growth Factors and General Fund-State Expenditure Limit

- ⌘ Establishes a "fiscal growth factor" based on a three-year average of inflation plus population change.
- ⌘ Mandates an annual General Fund-State expenditure limit, to be calculated by the State Expenditure Limit Committee each November, based on the fiscal growth factors applied to previous year's expenditure limit.
- ⌘ Requires the Governor's budget to be consistent with the expenditure limit, and restricts annual General Fund-State expenditures to the limit.
- ⌘ Requires the expenditure limit to take effect on July 1, 1995.
- ⌘ Allows temporary expenditures above the limit after declaration of an emergency and a 2/3 vote of the Legislature for a law signed by the Governor.

Expenditure Limit Adjustments and Local Government Impact

- ⌘ Stipulates that future expenditure limits be adjusted for actual expenditures.
- ⌘ Requires a lowering of the limit for the transfer of a state program or function from the state General Fund to other source, or for the transfer of moneys from the state General Fund to other fund or account. The limit may be raised for monies or programs transferred in the other direction – i.e. from another state fund source to the state General Fund.
- ⌘ Allows the expenditure limit to be increased or decreased for transfers of program costs between federal or local governments and the state.

- ⌘ Prohibits the Legislature from imposing responsibility for new programs or services on local governments without a specific appropriation to fully reimburse costs.

Emergency Reserve Fund

- ⌘ Establishes an Emergency Reserve Fund to receive state revenues above the expenditure limit.
- ⌘ Requires a 2/3 vote of the Legislature to spend funds out of the Emergency Reserve (only if those expenditures do not cause total expenditures to exceed the expenditure limit).
- ⌘ Requires any Emergency Reserve Fund balance exceeding 5 percent of annual GF-S revenues be deposited into the Student Achievement Fund for distribution to K-12 school districts for class size reduction and other education improvements (per Initiative 728, adopted by voters in November, 2000).
- ⌘ Allows Emergency Reserve Funds to be appropriated for other purposes only after a 2/3 vote of the Legislature and a vote of the people at the next general election.

Taxes and Fees

- ⌘ Requires a 2/3 vote of the Legislature to raise state revenues (or make a revenue-neutral tax shift) after July 1, 1995.
- ⌘ Additionally requires voter approval if the state revenue measure results in expenditures above the expenditure limit.
- ⌘ Limits state fee increases to the fiscal growth factor unless legislative approval is received.

The Debt Limit

There are two debt limits imposed on the state's ability to borrow funds to finance government programs in the capital budget: the constitutional limit of 9 percent of general state revenues; and a more restrictive statutory limit of 7 percent of general state revenues. The state cannot sell general obligation bonds if the debt service from that sale will cause total debt service to exceed 7 percent of the average of general state revenues for the preceding three fiscal years.

The size of bonded capital programs affordable under the debt limit can change, depending on:

- ⌘ The amount of new projects in the capital budget,
- ⌘ Changes in revenue forecasts that increase or decrease state revenues,
- ⌘ Changes in the structure of borrowing (e.g. length of term on bonds), and/or
- ⌘ Changes in the interest rates at which bonds are sold.

GLOSSARY OF BUDGET-RELATED TERMS

Allotment—An agency's plan of estimated expenditures and revenues for each month of the biennium.

Appropriation—The legislative authorization to make expenditures and incur obligations from a particular fund. Appropriations typically limit expenditures to a specific amount and purpose within a fiscal year or biennial timeframe.

Biennium—A two-year fiscal period. The Washington State biennium runs from July 1 of an odd-numbered year to June 30 of the next odd-numbered year.

Budget Drivers—Economic or demographic factors that have a significant effect on the state budget. Examples: inflation rate changes, state population in certain age groups.

Budget Notes—A legislative fiscal staff publication that summarizes the budget passed by the state Legislature. This publication is usually distributed a few months after the end of the legislative session. Budget notes provide guidance but do not have the same legal implications as appropriation bill language.

Bow Wave—Any additional cost (or savings) that occurs in the future because a budget item in the current biennium is not fully implemented. Example: A program started in the last six months of this biennium might cost \$100,000. If that program operates for a full 24 months next biennium, costing \$400,000, then the current biennium budget decision is said to have a *bow wave* of \$300,000.

Capital Budget and Ten-Year Capital Plan—The long-term financing and expenditure plan for acquisition, construction, or improvement of fixed assets such as land and buildings.

Debt Limit—Washington State's legal restriction (RCW 39.42.060) on the amount that can be paid for debt service on bonds, notes, or other borrowed money. The statute mandates that payments of principal and interest in any fiscal year cannot exceed 7 percent of the arithmetic mean of general state revenues for the three preceding fiscal years. The State Constitution (Article 8, Section 1(b)) contains a similar, but higher, debt limit of 9 percent of revenues.

Dedicated Funds—Funds set up by law to receive revenue from a specific source and to be spent for a specific purpose.

Entitlement—A service or grant that, under state or federal law, must be provided to all applicants.

Fiscal Year—A one-year fiscal period. The state fiscal year extends from July 1 through the next June 30. The federal fiscal year runs October 1 through September 30.

Fiscal Note—A statement of the estimated fiscal impact of proposed legislation. This cost estimate is usually developed by the state agencies affected by the bill, and then approved and communicated to the Legislature by the Office of Financial Management.

Full-Time Equivalent (FTE)—*As a unit of measure of state employees:* refers to the equivalent of one person working full-time for one year (approximately 2,088 hours of paid staff time). Two persons working half-time also count as one FTE. *As a unit of measure of students in K-12 or Higher Education facilities:* refers to the equivalent of one student attending class full-time for one school year (based on fixed hours of attendance, depending on grade level).

Fund—An independent budget and accounting entity with a self-balancing set of accounts representing all related resources, obligations and reserves. Most funds are set up in state law to isolate specific activities.

General Obligation Bonds—Bonds whose repayment is guaranteed by the "full faith and credit" of the state.

General Fund-State—The *general fund* represents all financial resources and transactions not required by law to be accounted for in other funds. *General Fund-State* (GF-S) refers to the basic account that receives revenue from Washington's sales, property, business and occupation, and other general taxes; and is spent for operations such as public schools, social services, and corrections.

Incremental Budgeting—Any budget development approach that focuses on incremental changes to a previous spending level or other defined expenditure base.

Initiative 601—A law on state budget restrictions passed in the November 1993 general election. Its primary requirements are: an *expenditure limit* based on inflation and population growth (applicable to state General Fund expenditures only); an *emergency reserve account* for any GF-S revenues above the expenditure limit; a percentage limit on how much state fees can be raised without legislative approval; and a 2/3 legislative vote requirement on certain state tax increases.

Maintenance Level—A projected expenditure level representing the estimated cost of providing currently authorized services in the ensuing biennium. It is calculated using current appropriations, the bow wave of legislative intentions assumed in existing appropriations (costs or savings), and adjustments for trends in entitlement caseload/enrollment and other mandatory expenses. This number establishes a theoretical base from which changes are made to create a new budget.

Nonappropriated Funds—Funds where expenditures can be made without legislative appropriation. Only funds specifically established in state law as being exempt from appropriation fall into this category.

Operating Budget—A biennial plan for the revenues and expenditures necessary to support the administrative and service functions of state government.

Performance Measure—A quantitative indicator of how programs or services are directly contributing to the achievement of an agency's objectives. These indicators may include measures of inputs, outputs, outcomes, productivity, and/or quality.

Proviso—Language in budget bills that places a condition on the use of appropriations. Example: "Up to \$500,000 of the General Fund-State appropriation is provided solely for five additional inspectors in the food safety program."

Reappropriation—Capital budget appropriation that reauthorizes the unexpended portion of previously appropriated funds. Capital projects often overlap fiscal periods and it is necessary to reauthorize some expenditure authority to ensure project completion.

Reserve, or Fund Balance—In budget terminology, the difference between budgeted resources and expenditures.

Reversion—Unused appropriation authority. If an agency does not spend all its appropriation in the timeframe specified by the budget, the authorization to spend that dollar amount expires.

Supplemental Budget—Any legislative change to the original budget appropriations.

